# 2 Framework for trans-Tasman integration

|  |
| --- |
| Key points |
| * Economic integration is about freedom of exchange, and the consequential flows of goods, services, capital, technology, knowledge and people. Economic integration often involves removing or lowering barriers or distortions created by government policy. These barriers can be intended (for example, tariffs and restrictions on foreign direct ownership) or unintended (for example, compliance costs caused by differences in business regulation). * Policies to encourage closer economic integration can improve the productivity of the Australian and New Zealand economies. Some policy initiatives can, however, impose net costs. * The key question for this study, given the existing close economic relations between the two countries, is which opportunities for further integration can improve the wellbeing of Australians and New Zealanders. * The Commissions’ approach is to recommend policy initiatives that provide net benefits for both countries, even where the distribution of benefits favours one country. However, where a policy initiative provides benefits in aggregate, but is likely to have a net cost for one country, results are reported for possible consideration by Governments as part of a wider package of actions. * The joint net benefits from further integration will be increased if policy initiatives are outward looking and generally do not impede profitable exchange with other trading partners. Initiatives should take account of linkages with other agreements and be consistent with domestic policy improvement. * Analysis of integration initiatives should take into account both direct and indirect costs and benefits, should be proportionate to the importance of the issue being considered, and be publicly available. * A ‘direction of travel’ towards a single economic market has been characterised by Prime Ministers in terms of a seamless market in which people and businesses can have a ‘domestic-like’ experience in either country. How far Australia and New Zealand go in this direction should emerge from good public policy processes focused on the achievement of net benefits. * The services sector is likely to be a key part of the future integration agenda, given its significance to both economies and common policy objectives in many areas. |
|  |
|  |

Australia and New Zealand are closely integrated, both economically and socially. Personal ties are extensive and deep with more than 40 000 flights across the Tasman each year, around 480 000 New Zealand-born people living in Australia, and around 65 000 Australian-born people living in New Zealand.

Commercially, Australia is New Zealand’s single largest export market and more than half of foreign direct investment (FDI) in New Zealand comes from Australia. As Australia’s economy is over seven times the size of New Zealand’s (on a purchasing power parity basis), the commercial significance of New Zealand for Australia is smaller but nonetheless important. For example, New Zealand is a significant market for Australia’s manufactured exports and Australians held investments in New Zealand worth about A$74 billion in 2010.

There is considerable cooperation between government agencies. The two countries have similar political, legal and economic institutions, share the same language and have cultural similarities, leading to a relationship that New Zealand’s Prime Minister describes as being ‘like no other’ (Key 2011) and Australia’s Prime Minister describes as ‘family’ (Gillard 2011a).

Governments provide the framework within which people and businesses make integration happen. In the case of Australia and New Zealand, this framework consists of many agreements and a commitment to a single economic market agenda. Although ‘the ditch’ is a natural impediment to trans-Tasman integration, falling transport costs and new communication technologies are reducing its significance.

The key question for this study, given the existing close economic relations between the two countries, is which opportunities for further integration can improve the wellbeing of Australians and New Zealanders.

This chapter describes the benefits from economic integration in general and from further integrating the Australian and New Zealand economies in particular. There are also costs that need to be accounted for or managed. Finally, the chapter sets out a conceptual framework to help ensure that policy initiatives to promote further integration maximise the *net* benefits — the difference between benefits and costs — that closer integration can bring.

## 1 Economic integration and the role of government

### Defining integration

‘Economic integration’ is about the freedom of exchange of goods, services, capital, technology, knowledge and people between countries. All else equal, such integration expands as transaction costs are reduced (box 2.1).

Benefits from economic integration include greater trade and increased mobility of labour, capital and knowledge, which in turn can generate benefits from specialisation and economies of scale.

There are commercial incentives in markets to reduce transaction costs in a myriad of ways — including through innovation in communications, transport and logistics, through information and insurance markets, by adapting institutions including firm structures (such as multinationals), and through agglomeration.

### How governments influence integration

Government policies influence transaction costs, thereby facilitating or hindering economic integration. Governments can intervene: between theborders of two countries through mechanisms that affect transport costs; at the border*,* by imposing barriers such as tariffs; and behind the border through, for example, consumer protection and food safety regulations, which affect market access for foreign producers. Table 2.1 provides examples of where such barriers might affect the movement of goods, services, capital and labour. There may also be impediments to knowledge transfers and to productive interactions between government organisations and services.

|  |
| --- |
| Box 2.1 Transaction costs: why borders matter |
| In the context of economic integration between countries, transaction costs refer to costs which are incurred in trade, or the movement of resources across borders. They include a variety of costs ranging from transport and regulatory compliance through to information-gathering and coordination.  Transaction costs can be classified according to their causes — being either policy‑related or structural — and where they occur relative to a particular border. The figure below is illustrative, allocating a selection of transaction costs according to whether they are mainly structural or policy-related. |
| (Continued next page) |
|  |

| Box 2.1 (continued) |
| --- |
| Figure **Transaction costs: types and determinants**   |  | | --- | |  |   The extent of transaction costs applying to trade across a border has been referred to as the ‘thickness’ of that border. Thinner borders enable closer economic integration. While governments may want to reduce some transaction costs to facilitate economic integration, they may also wish to preserve the benefits of borders — such as tailoring regulatory systems according to their economic characteristics and citizens’ preferences. Accordingly, governments are more likely to be able to reduce the thickness of borders with countries with which they have more compatible institutions and governance.  While policy-related transactions costs, such as tariffs, can be addressed directly by changing government policy, structural transaction costs resulting from geography and technology can only be influenced indirectly. For example, governments can improve transport efficiency by removing distortions in transport and infrastructure markets. |
| *Source*: World Bank (2009). |
|  |
|  |

Government actions can affect transaction costs in three main ways.

* Governments can reduce transaction costs by providing the institutional and legal platforms required for well-functioning markets, including the rule of law (to enforce contracts) and a robust system of property rights. These platforms can extend across national borders; for example, linking countries’ intellectual property regimes (discussed in chapter 4).
* Some government policies, whether deliberately or inadvertently, increase transaction costs, impeding exchange and distorting economic activity without correcting a market failure. Such policies — for example, tariffs and other trade barriers — unambiguously reduce efficiency and community wellbeing.

Table 2.1 Organising framework, with illustrative impediments

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| *Type of exchange* | *Point at which impediment occurs* | | | | |
| *Between-the- borders regulation* | *At-the-border regulation* | *Behind-the-border regulation* | | |
| *Lack of national treatment* | *Other* | |
| **Goods** | Maritime and air transport costs | Tariffs and  non-tariff barriers | Bias in government procurement | | Consumer  law |
| **Services** |  |  |  | |  |
| *Mode 1:  Cross-border trade* | Post and tele-communications costs |  | Bias in government procurement | |  |
| *Mode 2: Consumption abroad* | Transport costs | Migration laws |  | |  |
| *Mode 3: Commercial presence* |  | Foreign investment  laws | Ownership requirements | | Impediments to establishment and operations |
| *Mode 4: Movement of persons* | Transport costs | Migration laws | Eligibility for government programs | | Occupational licensing |
| **Capital** |  | Screening of foreign investment | Ownership requirements | | Prudential regulation |
| **Labour** | Transport costs | Migration laws | Eligibility for government programs | | Occupational licensing |

* The third situation is more complex. When governments intervene to correct market failures, their intervention may increase transaction costs for domestic and foreign businesses and impede cross-border trade. If these interventions are efficiently implemented to address a clearly specified problem such as pollution, they will enhance community wellbeing even if they reduce trade. But if the transaction costs are unnecessarily high — say, because of poorly designed intervention — they may impede trade that could have benefited both countries.

Only case-by-case analysis can reveal whether reducing transaction costs has net benefits. Box 2.2 provides a hypothetical example.

|  |
| --- |
| Box 2.2 Different product safety standards that increase transaction costs: improved wellbeing or a barrier to integration? |
| Suppose that two countries have different product safety standards for electrical products. Exporters from the country with less stringent standards (A) have to redesign products for export to the other country (B). This is a transaction cost that may impede exports from country A to country B. But is this an economic problem?  One way to remove the cost of redesigning the product for different markets would be for the two countries to harmonise their safety standards at the more stringent level of country B. But this will increase the prices that domestic customers in country A will have to pay for electrical products, although they will benefit from a higher level of safety. Another approach, mutual recognition, would enable producers in country A to export to country B without redesigning their products. But this may expose consumers in country B to products with lower safety standards, although they may benefit from lower prices.  Whether to implement harmonisation or mutual recognition, or retain different standards in cases such as this, depends on factors such as: the extent of differences in attitudes and preferences; the number of firms operating in both jurisdictions; and the size of policy-related transaction costs. |
|  |
|  |

The challenge for policy makers is to ensure that transaction costs are not excessive, and do not unduly impede the movement of goods, services, labour and capital across borders. The benefits of international trade are more likely to be achieved under these conditions. Countries are able to specialise in producing those goods and services in which they have a comparative advantage, firms can reap scale economies in production and there is increased dynamism in local industries that are no longer sheltered from international competitors. Knowledge is transferred more freely across borders, and capital and labour move to higher value uses.

These benefits, however, are associated with economic integration in general. This study is about economic integration between Australia and New Zealand. What are the potential benefits and costs of policies that focus on closer integration between Australia and New Zealand, in a world with other integration opportunities?

## 2 What are the potential impacts of trans‑Tasman economic integration?

To provide a framework for assessing policy initiatives, this section sets out the potential benefits of bilateral integration and then the potential costs.

### There are significant potential benefits

#### Specialisation and economies of scale

In small economies it is difficult to achieve scale economies by supplying only domestic markets. A free international trading environment enlarges markets, helping to overcome this problem. When there is free international trade, ‘the benefits of large country size fade away’ (Alesina and Spolaore 2005, p. 13), at least in relation to traded goods. When trade or other barriers remain, negotiating better market access to specific countries — particularly ones that are larger — becomes a means to specialise production, expand market size and achieve economies of scale.

There is considerably less trade across the Tasman in services than in goods (chapter 3). Although the services sector is only partly amenable to cross-border trade, recent technological advances are making services more tradeable. For example, lower communication costs are making remote medical consultations feasible. This suggests that the services sector should be a focus of the future integration agenda, especially given that much of the agenda for integrating the goods sector has already been completed.

#### Increased competition

Many industries have only a small number of competitors due to the relatively small size of some markets in Australia, and even smaller markets in New Zealand. As the Chair of the New Zealand Commerce Commission observed:

Being a small economy, New Zealand businesses understandably face challenges in acquiring the scale to operate efficiently and compete effectively, especially in global markets. The level of aggregation that may be tolerated in New Zealand markets is therefore higher than in some larger economies. (Berry 2011, p. 1)

To the extent that integration between Australia and New Zealand increases market size, it may increase the number of competitors in markets and reduce barriers for potential entrants. Greater competition can encourage firms to be more efficient and innovative.

The relationship between competition, capital markets and innovative economies, where scale and specialisation play out, is important. It results in complex activity and greater productivity, which is difficult to quantify, although some evidence is presented in Chapter 3.

#### Scale and government services

Cooperation between governments can generate economies of scale that reduce the cost of the services they deliver. Food Standards Australia New Zealand (FSANZ) and the proposed Australia New Zealand Therapeutic Products Agency (ANZTPA) are examples of the two Governments jointly providing a regulatory service.

The New Zealand regulatory impact statement on ANZTPA observed that:

The economies of scale and removal of duplication that would result from regulating jointly with Australia would lower overall administrative and compliance costs. The actual impact on New Zealand would depend on how the costs were shared between the two countries in the longer term, but the overall compliance costs for New Zealand industry would be lower in a joint scheme. (ANZTPA 2002, p. 6)

Integration of government services can involve considerable redesign of systems when values and preferences differ between countries — as the history of ANZTPA illustrates (chapter 3) — and so opportunities for joint provision need to be selected carefully.

#### Labour mobility

People mobility has been an important feature of the trans-Tasman relationship since the 19th century. Movement of people between countries — as currently applies under CER — allows labour to be allocated to its most productive use and to acquire new skills. The prospect of better employment opportunities abroad should encourage more people to pursue education, which can help raise productivity. Trans-Tasman labour flows have helped to address short-term imbalances in the Australian and New Zealand labour markets (PC 2010).

The overall economic effects of migration depend on a complex set of factors. The Australian Commission (PC 2006a) identified various ways in which immigration and population growth might be linked to increased productivity and income per person, including through: effects on sectoral reallocation of economic activity; the supply of labour; scale economies and competition; taxation; and government expenditure on services and transfer payments. The overall outcome is an empirical matter as some factors contribute positively and some negatively.

Supplementary paper D discusses labour mobility in detail.

#### Knowledge transfers

Knowledge is a key source of innovation. The pathways through which knowledge can be transferred between Australia and New Zealand include:

* business linkages, such as through ‘learning through exporting’ and through FDI. Foreign investment often brings with it new technology, some of which may be passed on to local firms, and new skills for local workers, which they take with them when they move to other employment. Knowledge transfer might be further enhanced if foreign firms find a larger, integrated, Australia-New Zealand market more attractive in which to establish a presence. Chapter 4 discusses whether restrictions on FDI between Australia and New Zealand should be relaxed
* integration within the government sector, as illustrated by the Australia and New Zealand School of Government (ANZSOG). ANZSOG was established in 2002 by the New Zealand, Australian, and three state Governments and a consortium of universities and business schools from both sides of the Tasman. It provides Masters and leadership programs for public servants, and funding for research relating to public administration, with a trans-Tasman focus. Collaborative government funding of research projects is another example
* cross appointments of senior staff
* education exports, where students travel across the Tasman to study.

Knowledge transfer can also happen in policy areas. A clearly superior policy approach in one jurisdiction might be adopted by others, particularly if there is transparent assessment, benchmarking, and evaluation of costs and benefits. Chapter 3 describes cases where policy knowledge has travelled across the Tasman.

#### Promoting good domestic policy

Domestic policies that improve the productivity of industries in one economy’s traded goods sector increase pressures on industries in the other economy to increase their productivity, in order to remain competitive (box 2.3). Greater openness to trade and factor flows can expose rigidities that impede structural adjustment and thus puts pressure on governments to address those rigidities. The negotiation of integration agreements offers an opportunity to identify and leverage such initiatives. Integration agreements may reduce domestic concern over reform by making it a quid pro quo for improved market access in partner countries (PC 2010). The negotiation process also provides opportunities to identify best practices to improve regulation and policy development.

|  |
| --- |
| Box 2.3 Modelling trans-Tasman effects of productivity improvements |
| Productivity improvements in one country (country A) affect output in its trading partner (country B) through various mechanisms.   * They increase the relative competitiveness of country A, expanding its global market share and output, and decrease that of country B, decreasing its output. * They increase returns to factors of production and incomes in country A, which increases demand for imports from country B and its aggregate output. * An increase in returns in country A causes factors to shift from country B to country A. This contributes to increasing aggregate output in country A and decreasing it in country B.   The net effect on country B is an empirical matter, which depends on the nature and extent of its connections with other economies.  The ANZEA model (box 2.9) was used to illustrate the effects of domestic policy initiatives in Australia and New Zealand. The two simulations consist of a 1 percent improvement in the productivity of all factor inputs in each economy, which translates into a 1 percent increase in GDP.  Productivity improvements in New Zealand are estimated to have very little effect on Australia. There is a small substitution in favour of New Zealand sourced production in both Australia and New Zealand as a result of reduced production costs in New Zealand (in particular, in agriculture and food processing). This is compensated by an increase in New Zealand’s demand for Australian exports, which are required for additional construction activity and investment.  Somewhat larger effects are at work when productivity improves in Australia. An increase in Australian income and consumption leads to an increase in Australia’s demand for New Zealand exports, most notably food and other manufactured products. This partly offsets the export contraction that New Zealand firms experience in other foreign markets as a result of increased Australian competitiveness. |
| *Source*: Supplementary paper E. |
|  |
|  |

#### Benefits for consumers

Consumers benefit from a wider range of price and quality offerings when integration brings specialisation, exploitation of economies of scale, competition, mobility and better government services than would otherwise have been possible.

### There are also potential costs

While bringing potential benefits, integration initiatives can give rise to costs that should be taken into account.

#### Trade diversion

Trade agreements that give member countries more favourable market access than to non-member countries can lead to ‘trade diversion’.[[1]](#footnote-1) This means that more profitable exchanges with non-members can be crowded out by the induced expansion of exchange among members, possibly to the extent that national incomes in the member countries decline, despite gains to producers.

This issue is most commonly raised in the context of preferential tariffs on merchandise trade. Preferential easing of other cost-raising barriers at the border (such as screening of FDI or quarantine procedures), where this can be done without compromising legitimate government objectives, reduces costs on the exporting partner countries and could reduce prices for the importing partner. Prices could, however, be lower still if unnecessary barriers were removed for all trading partners (box 2.4).

Many remaining barriers to trade in services and factor flows lie behind the border. In certain cases, these impediments will arise because foreign firms and individuals are treated differently from locals (for example, schemes that give preference to local suppliers). With integration, gains will flow to those foreign suppliers with preferential access to the local protected market. The local economy will gain from any increase in competition that lowers prices. In these cases, there would be no diversion from suppliers in non-partner countries, but there would be crowding out of local suppliers by lower-cost suppliers in the partner country with preferred access. Again, prices could be lower still if the local preference were removed from all imports that met the required quality standard.

|  |
| --- |
| Box 2.4 Preferential easing of barriers at the border |
| A preferential tariff provides the equivalent of an export subsidy to exporters in partner countries, as it increases their competitiveness relative to exporters in the rest of the world. If the resulting exports from partners simply replace lower cost ones from elsewhere (trade diversion) then the country giving the preferential treatment is worse off — total imports are unchanged but it has forgone tariff revenue to the benefit of exporters in partner countries. With reciprocity of preferential tariffs, each country could be worse off even though their exporters would be better off.  For a country to benefit from giving a tariff preference, it is necessary (but not sufficient) for domestic prices of the import to decrease. In this case there will be benefits from the additional lower-priced imports (trade creation), but there will still be trade diversion losses from the replacement of lower-cost third-party goods with higher‑cost partner-country goods. Thus, even in this more favourable circumstance, it is unclear whether giving a tariff preference yields national gains. Gains are more likely when partner country exporters are low-cost producers by world standards and their export supply is responsive to price changes.  Where barriers at the border impose real costs on foreigners (such as screening of foreign direct investment capital or unnecessary quarantine procedures), preferential treatment (without compromising legitimate domestic policy objectives) would reduce costs for exporters in the partner country and generate gains to the importing country to the extent the domestic price fell. An expansion of exports from the partner would crowd out exports from third-party suppliers, but this diversion would not impose a cost on the importing country. That said, prices could be lower still if purely protective barriers were removed for imports from all countries. |
|  |
|  |

Behind-the-border barriers will often simply reflect a country’s way of doing business, or local circumstances and preferences. Harmonising regulations to reduce the costs for businesses operating across partner countries would inevitably require some change in regulations in one or both of the partner countries. Such changes could increase the cost of regulation for trade-exposed businesses in one or both countries, potentially reducing their international competitiveness.

#### Implementation costs

Integration initiatives typically create implementation costs for governments and the private sector. Most of the initiatives discussed in chapter 4 would require negotiation, redesigning or setting up new systems, and training people to use these systems.

#### Fiscal costs of labour mobility

Trans-Tasman migration has implications for government expenditure on services (such as education and health) and transfer payments (such as social security). It also affects taxation revenue. While migration can lead to more efficient allocation of labour, open access to taxpayer-funded resources when there are uneven people flows can be a drain on budgetary resources in the destination country. There can also be pressures on the other country if, for example, emigrants return home when they become eligible for pensions, having worked and paid taxes in the source country. Chapter 4 considers options for balancing these opposing pressures.

#### Trans-Tasman versus local preferences

Regulatory integration usually involves some degree of acceptance by each country of the regulatory settings of the other. The gains from harmonising regulatory systems might be reduced if the agreed uniform regulations, standards or policy settings differ from what communities would otherwise choose. People in the two countries might prefer different trade-offs between costs and regulatory outcomes. The slow progress towards establishing ANZTPA is an example of disagreement about where this trade-off is best set.

#### Potential risks for domestic policy

While a bilateral agreement can encourage domestic policy improvements, focusing on bilateral initiatives could divert attention from the domestic policy agenda. Ai Group noted that it:

… supports closer economic relations where the objective is to reduce the costs of doing business across the Tasman. However, Australia needs to consider resolving impediments to mutual recognition in the domestic Council of Australian Governments (COAG) context before embarking on this in a trans-Tasman context. Careful cost benefit analysis also needs to be undertaken of any reforms to ensure that net economic benefits are achieved and maximised and there are benefits to both parties. (sub. 38, p. 3)

And while economic integration provides opportunities to transfer policy knowledge across the Tasman, both countries should be receptive to better practices elsewhere. Federated Farmers of New Zealand noted that:

There is a perception in some quarters within New Zealand that adopting Australian policy, legislation, and institutions would in itself close the income gap between the two countries. Federated Farmers disagrees …

The Federation believes that New Zealand should adopt the best possible policy, legislation and institutions regardless of where they originate, whether it be New Zealand, Australia, the UK, the US, or the rest of the world. (sub. 33, pp. 5–6)

There is a risk that finalising an agreement becomes an end in itself and that negotiators accept a sub-optimal outcome. For example, changes to the duration of copyrights and other intellectual property provisions negotiated as part of the Australia United States Free Trade Agreement have reduced the likelihood of an appropriate balance between supplier and user interests in Australia’s intellectual property system (PC 2010).

Chapter 3 includes a discussion on the relationship between the implementation of CER and the domestic policy agendas in Australia and New Zealand.

#### Adjustment costs

Integration may bring structural adjustment and distributional effects as production methods and patterns change. This can happen whether integration is driven by market pressures or policy changes. For example, integration can impact directly on an industry’s workers and owners by increasing the scope for specialisation. It can also indirectly affect the wider community (box 2.5).

The transition costs of change are normally less long-lived than the benefits from moving resources to more productive uses. Nevertheless, adjustment costs can be concentrated in particular industries or regions. Small costs at a national level can be substantial for particular sectors or communities.

Where it appears that a policy will generate significant adjustment costs, governments can respond by:

* relying on generally‑available adjustment measures (such as government provided job search services and the social security safety net)
* accompanying the policy change with specific adjustment assistance measures (for example, financial compensation to those most affected)
* modifying the policy to reduce adjustment costs, to allow people to plan for change (for example, phasing it in)
* considering the case for modifying a policy following its initial implementation.

To improve on generally-available adjustment measures, specific measures need to be targeted, involve an equitable sharing of their financing costs, interact efficiently with other programs and policies, and be transparent and subject to appropriate accountability mechanisms (PC 2001).

|  |
| --- |
| Box 2.5 Economic integration and ‘hollowing out’ |
| ‘Hollowing out’ typically refers to the transfer of high-value economic activities or capacities from one community to another, as a result of changes in economic forces (Easton 2007; OECD 2011a).  The ‘hollowing out’ concern most relevant to this study is associated with agglomeration economies, which occur when economic activity gathers together, resulting in with high density and scale (World Bank 2009). A larger country may be better able to exploit such economies, leaving the smaller country to specialise in activities for which agglomeration economies are smaller or insignificant. Both capital and labour may then shift to the larger country (Fujita, Krugman and Venables 2000; World Bank 2009). This suggests that under certain conditions, increased trans-Tasman economic integration could lead to a net flow of labour and capital to Australia, with resources moving in order take advantage of larger agglomeration economies — widening the gap in GDP per capita between the two countries over time (McCann 2009; Easton 2007). While this might be a legitimate concern, the following observations can be made.  First, agglomeration diseconomies exist alongside agglomeration economies; for example, congestion and high land prices in cities. The preferred location for economic activities is dependent on the balance between these forces — and is different for each activity (Hugo 2011). Also, the location of some activities is determined by immobile inputs; for example, minerals and agricultural land (Becker, Glaeser and Murphy 1999). This suggests that productive economic activities will continue to be spatially distributed.  Second, economic changes in Australia and New Zealand are driven by many factors. Global forces such as technological developments and changes in the relative scarcity of resources are important. Outcomes reflect the interaction of all these forces, and their individual effects are difficult to disentangle.  Third, evidence does not support fears of a ‘brain drain’ of skilled workers from New Zealand to Australia (supplementary paper D).  Fourth, economic integration is a means by which small countries can participate in and benefit from the wider and deeper markets of larger countries (World Bank 2009).  Integration carries some risks. However, policy in small countries can best address these risks by enhancing the adaptability of communities within a productive and open economy (World Bank 2009) and targeting adjustment support where appropriate to directly‑affected individuals or communities. |
|  |
|  |

## 3 How much trans-Tasman integration?

The benefits and costs of integration will alter as technology, preferences and a host of other factors change. This means that the end point — in terms of the extent of beneficial economic integration — will evolve with changing circumstances. It can be thought of as a moving target that should naturally emerge from good public policy processes focused on the achievement of net benefits.

Some submitters suggested that both the direction of travel and the end point matter and that the Commissions should develop a vision for the economic relationship. The Australia New Zealand Leadership Forum stated that the draft report ‘could, and should, be strengthened by providing a clear strategic vision for the economic relationship between Australia and New Zealand’ (sub. DR120, p. 1). The Commissions consider that the history of the relationship shows that it is better to anchor the future of CER and SEM in sound governance arrangements that can quickly and effectively identify and address issues as they arise, than in a vision. Chapter 5 looks at strengthening governance arrangements for this purpose.

This conclusion is consistent with the seven principles for the Single Economic Market (SEM) that Prime Ministers announced in 2009 (box 2.6). New Zealand’s Minister of Commerce explained that:

… the single economic market vision is not an articulated grand outcome but one built on principles that should govern our approach and accelerate the construction of key regulatory outcomes that will deliver a low-cost, innovative, and more seamless trans‑Tasman operating environment for businesses. (Power 2009)

While the first six SEM principles were developed in the context of business regulation, the Commissions consider that they provide a ‘direction of travel’ for future CER initiatives more generally.

The seventh principle — to optimise net trans-Tasman benefit (referred to as ‘joint net benefits’ in the study terms of reference) — provides an over‑arching test for the other six. It conveys that the other principles in box 2.6 should not be interpreted as objectives to be achieved in an absolute sense. For example, it is unlikely to be consistent with optimising joint net benefits for persons in Australia and New Zealand *never* to have to engage in the same process or provide the same information twice. Individuals who earn income in both countries, for instance, are likely to have to fill in tax returns in both countries unless tax systems are harmonised. Nevertheless, policy initiatives that reduce duplication of information provision are likely to be part of the single market agenda.

Building on the seventh SEM principle, the Commissions have sought to identify initiatives that would improve the wellbeing of the Australian and New Zealand communities.

|  |
| --- |
| Box 2.6 Single Economic Market principles |
| In 2009, the Prime Ministers of Australia and New Zealand announced seven principles for the SEM.   1. Persons in Australia or New Zealand should not have to engage in the same process or provide the same information twice. 2. Measures should deliver substantively the same regulatory outcomes in both countries in the most efficient manner. 3. Regulated occupations should operate seamlessly between each country. 4. Both Governments should seek to achieve economies of scale and scope in regulatory design and implementation. 5. Products and services supplied in one jurisdiction should be able to be supplied in the other. 6. The two countries should seek to strengthen joint capability to influence international policy design. 7. Outcomes should seek to optimise net trans-Tasman benefit. |
| *Source*: Rudd and Key (2009). |
|  |
|  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **F2.1** |  | The seven Single Economic Market principles, announced by the Prime Ministers in 2009, provide a useful direction of travel for future CER initiatives. |
|  |  |  |
|  |  |  |  |

## 2.4 Identifying the most promising initiatives

### Selecting initiatives for analysis

There are many areas in the economy where opportunities for integration could be explored — tariffs, transport costs, migration laws, consumer protection and government procurement are just a sample (table 2.1). For each of these areas, there are many possible impediments to integration, and many options for addressing each impediment.

The Commissions have focused on areas that seemed most likely to offer joint net benefits. They have then considered how much analysis to undertake in each of these areas, to test these expectations. There is no formula for doing this. To inform judgments about which areas might yield the largest joint net benefits, the Commissions used a set of filtering criteria, based on those used in similar scoping studies (box 2.7).

|  |
| --- |
| Box 2.7 Filtering criteria for integration initiatives |
| Criteria encouraging inclusion:   * width of reach (the number of entities and/or value of activity affected) * depth of reach (the extent to which entities are affected, including by high compliance costs) * information that the issue is critical for stakeholders from previous reviews, from submissions to the study, and from the Commissions’ engagement program * barriers that do not impose large costs, but ‘add up’ or cause unnecessary irritation and prevent a ‘domestic like’ experience in the other country * any other information that reform would generate large gains.   Criteria discouraging inclusion:   * likely high costs of the preferred policy option * affects an area where national autonomy matters. |
| *Sources*: Australian and New Zealand Productivity Commissions, drawing on Business Regulation and Competition Working Group (2011) and Regulation Taskforce (2006). |
|  |
|  |

Most of these criteria need little explanation. However, the role of national autonomy is less obvious. Many options for bringing about a closer relationship between Australia and New Zealand involve trading off some policy autonomy. This is not unusual, as there are many areas where national governments accept some loss of autonomy (for example, to local government or to international bodies, such as the World Trade Organisation) in order to achieve an overall benefit. But there will be limits on how large a reduction of autonomy is acceptable or indeed efficient.

The impact of CER on the Māori population is an important issue for New Zealand to take into account when new policy initiatives are being considered (box 2.8). The New Zealand Government will need to recognise any valid concerns that further integration initiatives are inconsistent with Treaty of Waitangi obligations.

|  |
| --- |
| Box 2.8 Trans-Tasman integration impacts for Māori |
| The Treaty of Waitangi places upon the New Zealand Government a responsibility to consider the impact of policy decisions on Māori.  The Māori economy historically included a strong focus on international trade, and there is ongoing interest in developing and maintaining international markets. The Māori Economic Development Panel (2012) noted that there is significant room for growth within the Māori economy. This, however, requires stronger connections with foreign markets. As such, trans-Tasman integration initiatives that aim to create a more ‘domestic-like’ business environment are likely to generate benefits for Māori businesses, many of which view Australia as a natural extension of their ‘home base’.  There are varying views among Māori about the merits of closer economic relations. Nga Hapu o Niu Tireni expressed concern that measures to enhance the trans-Tasman economic relationship impinge on the rights of Māori under the Treaty of Waitangi:  …we have seen major breaches [of the Treaty] with the formation of the Trans Tasman Food Standards Authority which undermines the mana and tino rangatiratanga of Hapu and whanau management of their own food in our home, farms, businesses, and marae, and also the Trans-Tasman Agency on Therapeutic Products which affect hapu and tohunga to practice our traditional medicines without consultation to hapu.a (sub. 20, p. 4)  While integration initiatives can raise questions about national autonomy, closer economic relations with Australia and the New Zealand Government’s ability to respect the Treaty of Waitangi are not necessarily incompatible. |
| a Māori words are explained in the glossary. |
|  |
|  |

In the limit, economic integration could extend to political union. The Commissions have not detected support for this option in either Australia or New Zealand, which is in any event outside the study’s terms of reference. Ruling out political union rules out or limits the scope for some economic integration initiatives that would necessitate adherence to common political and policy positions, such as a monetary union, common fiscal policy and harmonised tax systems.

While the consequential loss of autonomy may rule some policy options out of scope, many others do not raise autonomy concerns, particularly where preferences are similar in both countries. In these cases, the Commissions used the criteria in box 2.7 (other than the last one) to select areas for further analysis (chapter 4).

### How much analysis?

Equally important to selecting initiatives for analysis, is gauging how much analysis is needed to demonstrate that a proposal is the right one, while avoiding the risk of ‘paralysis by analysis’. This is a common problem in public policy, and is particularly significant when there is a large number of potential policy initiatives and there are multiple policy approaches to each of them. For example, table 2.2 lists some of the different approaches to the coordination of behind-the-border regulation.

Table 2.2 Types of regulatory coordination

|  |  |  |
| --- | --- | --- |
| Type of coordination | Trans-Tasman illustration | Strengths (S) and weaknesses (W) |
| **Unilateral** |  |  |
| Borrowing (New Zealand independently models a policy on Australian policy or vice versa) | New Zealand plans to introduce a single business number | S: Lower compliance costs for trans-Tasman businesses  W: Countries may interpret laws differently; consistency lost if one country alters its laws and the other does not |
| Unilateral recognition of regulatory settings | New Zealand recognises Australian safety standards without requiring Australia to reciprocate | S: Lower business compliance costs; simple to implement  W: Home country stakeholders have less say in overseas regulator’s decision making and limited or no appeal rights |
| **Cooperative** |  |  |
| Cooperation between regulators and enforcement agencies | Competition, tax and customs agency information sharing and enforcement assistance | S: More effective enforcement of business activity that crosses borders  W: Higher administrative cost |
| Mutual recognition | Trans-Tasman Mutual Recognition Arrangement | S: Lower business compliance costs  W: Countries may have differing preferences for level or type of regulation; home country stakeholders have less say in overseas regulator’s decision making; administrative cost of recognising more than one regime |
| Adopting common rules for separate institutions | Planned joint regulatory regime for Patent Attorneys | S: Lower business compliance costs; reduced costs in law-making; efficiencies in interpreting and applying the law  W: Inefficiencies if countries differ in preferences for level or type of regulation; administrative cost of ensuring common understanding of rules; higher cost of running separate institutions. |
| Adopting common rules, and establishing a single trans-Tasman institution | Australia New Zealand Therapeutic Products Agency (in progress) | S: Lower business compliance costs; reduced costs in law-making; efficiencies in interpreting and applying the law; economies of scale  W: Inefficiencies if preferences for level or type of regulation differ; cost of establishing a single regulator; loss of country-level flexibility; each country has less say in regulator’s decision making. |

*Source*: Adapted from Goddard (2002).

Comparing options means assessing their costs and benefits, to discover the one that generates the largest joint net benefits. Some costs (for example, implementation costs) are direct and quantifiable; others may not be, yet still need to be considered. For example, if reducing a tax that is distorting Australia-New Zealand commerce leads to a loss of revenue that has to be replaced by increasing another tax, the distortionary effects of this replacement tax should be included in the analysis.

The Commissions have used an economy-wide model to illustrate orders of magnitude of some integration initiatives considered in chapter 4 (box 2.9).

|  |
| --- |
| Box 2.9 Australia — New Zealand Economic Analysis model |
| The Australia–New Zealand Economic Analysis (ANZEA) model has been used to illustrate mechanisms at work in integration, especially where the outcome is an empirical matter that depends on a large number of assumptions. The ANZEA model is a multi-country general equilibrium model derived from the GTAP model and database. The GTAP model has been widely used to analyse the effects of policy initiatives.  A general equilibrium model represents — at an aggregate level — all economic transactions that take place within and between economies. It includes data and behavioural equations that describe international trade in goods and services, the use of labour, capital, land and other inputs in production, incomes paid to households, private and government consumption and investment, and taxes and transfers.  The ANZEA model differs from the GTAP model in two respects. First, the ANZEA model is built on a comparatively simple structure and has fewer equations than the original GTAP model. This simple structure facilitates modifications of the model to address issues relevant to the study and sensitivity analysis. Second, the ANZEA model accounts for bilateral capital flows at the industry level, which enables analysis of initiatives that relate to the commercial presence of services and FDI more broadly.  The ANZEA model divides the global economy into 25 separate economies including Australia and New Zealand, as well as the USA, the EU and the main economies in Asia.  Supplementary paper E provides details of the model and simulations. |
|  |
|  |

Analysis can, however, be resource-intensive and time consuming. And there will be limits to what is feasible. Hence judgments have to be made about the appropriate depth of analysis, and about the point at which conclusions can be reached, based on the underlying concepts and available quantitative assessments. The appropriate depth of analysis will be influenced by factors such as the size of potential costs and benefits (as suggested by the criteria in box 2.7), the number of feasible options, the availability of pre-existing evidence and analysis, and the cost of obtaining new data. A detailed analysis would take into account both direct and indirect costs and benefits, but the breadth and depth of analysis needs to be proportionate to the importance of the issue at hand.

This means that a proportionate approach will in some cases require detailed analysis, whereas in other cases options can be more readily ruled in or out (box 2.10).

|  |
| --- |
| Box 2.10 Depth of analysis ⎯ rules of thumb |
| A ‘proportionate’ approach would see some initiatives being ruled in or out without the need for extensive analysis. For example, the slow progress towards the national harmonisation of occupational health and safety regulation in Australia is a sign that the costs of achieving trans-Tasman agreement in this area are likely to be high in the foreseeable future. Unless the benefits of integration are expected to be very large, it seems reasonable to conclude without a great deal of analysis that the net benefits are unlikely to be positive.  The costs of trans-Tasman integration are also likely to outweigh the benefits when national governments have different objectives, reflecting different community preferences. For example, as the ACTU and the NZCTU point out, ‘many health and safety standards incorporate an element of judgement over acceptable risk that may differ between societies’ (sub. 17, p. 6).  On the other hand, situations where the two Governments have common objectives and similar policy instruments would be stronger candidates for integration, warranting less detailed analysis, because the costs are likely to be lower. |
|  |
|  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **F2.2** |  | Analysis of integration policy initiatives should take into account both direct and indirect costs and benefits, be proportionate to the importance of the issue being considered, and be publicly available. |
|  |  |  |
|  |  |  |  |

## 2.5 Desirable features of trans-Tasman integration initiatives

Initiatives that are compatible with broader integration and complement domestically-focused reforms are more likely to generate net benefits, and so the Commissions have sought to identify options with these characteristics.

### Compatibility with broader integration

Trans-Tasman agreements sit within the context of both countries having other bilateral, regional and multilateral agreements. This has two implications.

First, analysis of bilateral integration policy options should examine implications arising from other trade agreements to which either Australia or New Zealand is a party. For example, does a change to a CER agreement trigger changes in other agreements?

Second, a non-preferential approach to reducing barriers to trade avoids diversion effects and typically yields larger benefits (box 2.4). This was recognised at the inception of the CER by the intention that it be outward-looking, including through strengthening trading relationships with third countries.

There are, however, exceptions to this non-preferential approach. For example, mutual recognition of occupational licensing is based on acceptance by both governments of the standards in the other country. While extension of mutual recognition to other countries would extend markets, *automatic* multilateralextension could require a country to accept service providers from a third country whose standards are considered to be unacceptable. It is also difficult to envisage either government extending the freedom of trans-Tasman labour mobility multilaterally.

The general presumption in favour of non-discriminatory approaches, alongside the existence of significant exceptions, suggests that bilateral initiatives should not stall progress towards multilateral or plurilateral liberalisation unless there is a clear case for doing so. This can be achieved by aiming for non-discriminatory policies that permit similar arrangements with other trading partners, unless the benefits of a discriminatory approach clearly exceed its costs.

### Initiatives should complement domestic policies

Both Australia and New Zealand have a strong interest in good public policy across the Tasman and bear some of the (opportunity) cost of poor policy in the other country. While many domestic policy initiatives do not feature on the trans‑Tasman agenda, there are interdependencies that, if managed well, can promote both countries’ domestic policy reforms.

First, it is in each country’s interests to implement some initiatives unilaterally that are also on the trans-Tasman agenda. For example, reducing one country’s tariff barriers is nationally beneficial, irrespective of what the other country does. Taking this insight into discussions about the next steps for CER, rather than holding out for offsetting concessions, will accelerate progress.

Second, some domestic policies may increase, or create the potential to increase, trans-Tasman integration. For example, reforms to either country’s transport sectors that contribute to reducing trans-Tasman transport costs would facilitate integration. The costs involved in harmonising regulatory frameworks will be lower where there are nationally agreed approaches within Australia.

Third, political and bureaucratic effort needs to be allocated efficiently between the domestic and trans-Tasman policy agendas, which is more likely to happen when there is:

* proportionate, publicly-available analysis of options (as discussed earlier)
* an effective governance framework
* regular evaluation and benchmarking of policy initiatives, to inform government decisions about whether to extend, amend or end an initiative.

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **F2.3** |  | Joint net benefits will be increased if policy initiatives are: outward looking; generally do not impede profitable exchange with other trading partners; take account of linkages with other agreements; and are consistent with domestic policy improvement over time. |
|  |  |  |
|  |  |  |  |

## 6 Cross-country distributional effects

The benefits from removing barriers to integration between Australia and New Zealand may be distributed unevenly. A further consideration is how to take account of the large number of Australian and New Zealand citizens who live in the other country.

### Transfers between countries

Policies that deliver efficiency gains for the two economies in aggregate might involve income transfers between them. One view is that only policies that generate benefits for both countries should proceed. An alternative view (box 2.11) is that an uneven distribution of benefits, or even losses to one country, from a particular integration initiative, should not matter provided a ‘win-win’ outcome can be achieved overall. If the two countries agreed not to seek immediate reciprocity, but rather to act in the confidence that their cooperative actions will benefit both in the long term, more policy initiatives are likely to be accepted, certain complementary packages of initiatives could become attractive, and joint net benefits could be larger than otherwise.

The underlying reasons for the difference between these two views may be found in the limited use of formal compensation mechanisms between the two countries. Some commentators may have limited confidence that informal compensation will occur through the ‘swings and roundabouts’ of initiatives that benefit one country or the other over time.

|  |
| --- |
| Box 2.11 A ‘balanced benefits’ approach |
| In a speech in 2010, Mr Simon Power (then New Zealand Minister of Commerce) considered whether net benefits should be measured on a case-by-case basis or as a package.  The net trans-Tasman benefit] principle is explicitly designed to encourage both sides to think about and address issues in the context of strengthening the trans-Tasman economy. It requires each of us to move beyond a narrower national benefit calculation on an issue-by-issue basis.  The principle is designed to encourage both sides to address co-ordination issues in the longer-term context of the New Zealand and Australian economies becoming more deeply integrated and our respective national interests being more deeply linked to the health of the Australasian economy.  The principle encourages an overall balanced benefits approach across the range of areas under the Outcomes framework and more broadly to achieve the goals of a more seamless market. It allows for trade-offs.  This means that sometimes New Zealand may concede something in the interest of achieving other objectives and advancing the goal. At other times Australia will. |
| *Source*: Power (2010). |
|  |
|  |

Cases where a policy change would benefit both countries are recommended by the Commissions, even where the distribution of the benefits favours one country. The Commissions have made no attempt to rank recommendations on the basis of how these benefits would be distributed between or within each country.

A different approach is appropriate in the event that a policy initiative provides joint net benefits, but is likely to have a net cost for one country. Neither Commission considers that it could recommend an option in isolation that disadvantaged its country’s citizens, even if there are net trans-Tasman gains overall. In this event, the Commissions report the proposal and its potential impacts, for consideration by governments as part of a wider package of actions. Governments are better placed to combine multiple initiatives into a package that provides a win-win outcome over time.

### Impacts on trans-Tasman residents

There are different options for taking account of the impacts of trans-Tasman residents (citizens of one country who live in the other) (box 2.12).

|  |
| --- |
| Box 2.12 Accounting for trans-Tasman residents |
| A national cost-benefit analysis would assess the effects of policy changes at a national level, based on the welfare of residents. Spatial aspects of integration — such as the potential for ‘brain-drain’ — raise a question about the welfare of *citizens*, wherever they reside, versus the welfare of *residents*, because the two can diverge. With about 10 percent of New Zealanders living in Australia, and projection of a further 400 000 or so New Zealanders leaving New Zealand in the next 15 years (Yang and de Raad 2010), this is a significant issue. That said, population movements and their motivations are complex. Although many New Zealanders migrate, a significant proportion return, and many other migrants from around the world settle in New Zealand and Australia.  People who move between the two countries gain from having an opportunity to move to their location of choice. There are other effects, particularly associated with the taxation and social security systems. For example, elderly immigrants may receive pension and health entitlements in their new country without having contributed through taxation in that country. On the other hand, young emigrants have typically benefited from subsidised education before moving to another country where they pay taxes.  Options for considering the impacts on these residents in a cost-benefit framework include:   * not separately identifying the potential net benefits accruing to citizens of one country who live in the other * always separately identifying the potential net benefits accruing to citizens of one country who live in the other and attributing them to their country of citizenship * identifying the potential net benefits separately only in the case of policies that affect disproportionately the citizens of one country living in the other.   The ACTU and NZCTU support the second option, arguing that when considering the benefits and costs for each country, the outcomes for citizens of one country who are resident in the other should be identified separately (sub. 17). However, for many issues it would be difficult to do this, and those separate impacts will likely be negligible. |
|  |
|  |

For most issues, it would be both difficult and unnecessary to identify separately the impacts of policy initiatives on these people. As Lloyd points out:

… there are few issues in which the choice of the current New Zealand population or the current population plus NZ-born people living in Australia will make a difference to the policy choice. (sub. 5, p. 13)

Some issues, however — such as entitlements to social security benefits (discussed in chapter 4) — do affect trans-Tasman residents disproportionately. In these cases, the Commissions have separately identified the impacts on these residents.

1. Investment diversion can also occur where investors in partner countries face lower barriers to foreign investment relative to investors in non-partner countries. Supplementary paper C on FDI has a description of investment diversion and its possible effects. [↑](#footnote-ref-1)